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UNCLAS SECTION 01 OF 02 MEXICO 002738

SENSITIVE, SIPDIS

STATE FOR WHA/MEX, WHA/EPSC  
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MMS FOR RENEE ORR

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TAGS: [ECON](#) [ENRG](#) [EINV](#) [PGOV](#) [SENV](#) [MX](#)

SUBJECT: GOM LAUNCHES CONTROVERSIAL OIL REFINERY PROJECT

¶1. Summary: President Calderon announced August 2009 that state-owned oil company PEMEX selected Tula, Hidalgo as the site of its new "bicentennial" refinery, a state governed by the PRI opposition party. His statement brings to end a fierce eighteen-month battle between various Mexican states for the location of this USD 9 billion project. Energy experts agree that the project is driven largely by politics and resource nationalism. While Mexico refines over half of its crude oil, its growing reliance on imports of refined products (mostly from the U.S.) has become an increasingly sensitive political issue. Nonetheless, with declining oil production, lack of investment in exploration and low margins of return on refineries, building a costly new refinery at the expense of other projects makes little economic sense. Thankfully, there is plenty of time to kill this project before construction is set to begin in 2012 SUMMARY

¶2. Mexico has not built a new refinery since 1979. With six refineries in operation, Mexico's refining capacity has remained constant, while demand for gasoline has increased on average by 3.4% annually over the past twenty years. By 2008, Mexico imported 340,000 barrels per day of gasoline, 42.5% of Mexico's total gas consumption. To create value for its heavy crude with minimal cost and risk, PEMEX in 1993 bought from Shell Oil half its interest in its Deer Park refinery near Houston, establishing a joint venture. This investment gives Mexico some supply security, but does not address concerns that a significant and growing portion of Mexico's crude oil exports are re-imported as refined products.

¶3. PEMEX's domestic refining operations reflect years of underinvestment as officials opted to sink money into more lucrative oil exploration and production projects. The GOM's prohibition on foreign investment in refining and transportation activities exacerbated the problem. A government proposal under the 2008 Energy Reform which would have allowed private investment in these downstream activities was rejected by the Mexican Congress, leaving the Mexican government with no choice but to increase dependence on imported refined products or invest heavily in refining operations to increase capacity.

RELIANCE ON FOREIGN IMPORTS IS SENSITIVE ISSUE

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¶4. Mexico's growing reliance on imports of refined products became an increasingly sensitive political issue during the early years of the Calderon administration leading the government to choose greater investment in this sector at the expense of other projects. On March 18, 2008 (the 70th anniversary of the nationalization of Mexico's oil sector and the founding of PEMEX) President Calderon announced the government's plans to build a new refinery as an employment and infrastructure investment project. After intense political lobbying between Mexican states for this estimated 9 billion dollar project, the GOM announced in April 2009 that the new refinery will be built in Tula, Hidalgo if the state government

could secure the necessary land for the refinery within 100 days - no easy task given the power of local landowners or ejidos. With some difficulty, the State of Hidalgo was able to purchase most of the necessary 700 hectares of land at a cost of MXP 1.5 billion and donate it to PEMEX as an in kind contribution. Issues regarding land right could still be problematic. The state of Hidalgo is still negotiating with landowners about several small parcels of land.

15. With the location selected, PEMEX entered into a multi-year project design phase in which it will clarify the technical plans and further analyze site specific factors such as altitude and the potential for flooding. Engineering and construction contracts will likely be awarded beginning summer 2011. The construction phase of the project which will account for 85% of the project costs and most of the temporary employment gains, will begin in 2012, with the refinery scheduled to be fully operational 2015. PEMEX's new refinery will be built next to an existing refinery, and PEMEX will have an opportunity to take advantage of some infrastructure already in place. Tula is located inland some 100 miles north west of Mexico City, allowing the new refinery to supply heavily populated central Mexico, including Mexico City. PEMEX admits, however, that with a capacity of 300,000 to 400,000 barrels a day, the refinery will reduce but not eliminate Mexico's reliance on imports of refined products.

COMMENT: PURELY POLITICAL

16. Mexico's "bicentennial" refinery project is controversial. Energy industry experts agree that, with rapidly declining oil production and severe budgetary shortfalls, Mexico would be better

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off investing in exploration activities. The low rates of return for investment in refining make this project an unattractive alternative. Moreover, by the time this project is scheduled for completion, Mexico may not produce enough domestic oil for its refineries. Financing is also problematic. PEMEX says it will rely on outside financing (capital markets) to fund up to one third of the project, but it is far from clear whether this is feasible. The impetus behind the project is purely political. President Calderon came under enormous pressure not only to build the refinery, but to do so in a state in which the opposition PRI is in power. Many industry analysts - who overwhelmingly oppose the project - believe the refinery will never be built. There is plenty of time to kill this project before construction is set to begin in 2012.

PASCUAL